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June 13, 2017

Via E-mail

Jennifer Piorko Mitchell,
Office of the Corporate Secretary,
FINRA,
1735 K Street, NW,
Washington, DC 20006-1506.
(pubcom@finra.org)

Re: Regulatory Notices 17-14 and 17-15

Dear Ms. Mitchell:

We are pleased to submit this letter in response to FINRA's request for comment relating to FINRA rules affecting capital formation. We appreciate FINRA's efforts to engage in continued review of its rules in response to changes in the capital markets and its willingness to consider the effectiveness and efficiency of its existing rules in practice. In particular, we believe that FINRA should reconsider the application of its rules in light of the now well-seasoned regulatory regime applicable to well-known seasoned issuers ("WKSIs")[1] and other issuers eligible to file on Forms S-3 and F-3.

Rule 5110 – Corporate Financing Rule – Underwriting Terms and Arrangements

FINRA Rule 5110 prohibits unfair and unreasonable underwriting arrangements in connection with the public offering of securities. The Rule was adopted in 1992 in response to "persistent problems with underwriters dealing unfairly with

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1 In this letter we use the term "well-known seasoned issuer" as defined in Rule 405 under the Securities Act of 1933.

issuers" and requires members participating in a public offering to file information with FINRA about the underwriting terms and arrangements. FINRA's Corporate Financing Department reviews this information before the commencement of the offering to ensure member firm compliance with requirements of Rules 5110 and 5121.

FINRA Should Exempt Offering of Securities Registered on Forms S-3 and F-3 Entirely from the Requirements of Rule 5110.

In Regulatory Notice 17-15, FINRA has requested comments on a modernization of Rule 5110, which seeks to improve the administration of the Rule and simplify its application. We appreciate these efforts and believe the proposed amendments facilitate these goals. However, we believe FINRA should consider exempting all offerings of securities registered on Forms S-3 and F-3 entirely from the Rule – both the substantive and filing requirements. At a minimum, we believe that FINRA should revise its "experienced issuer" definition to conform to existing Forms S-3 and F-3.[2] The SEC's securities offering reform is now over a decade old and, in our view, offering practices by issuers eligible to file on Forms S-3 and F-3 are

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2 FINRA is proposing to amend the rule to delete specific reference to the "1992 standards" and instead exempt offerings of securities registered with the SEC on registration statement Forms S-3, F-3, or F-10, provided that the registrant is an "experienced issuer". The term "experienced issuer" means an entity that has (A) a reporting history of 36 calendar months immediately preceding the filing of the registration statement; and (B) at least $150 million aggregate market value of voting stock held by non-affiliates; or alternatively the aggregate market value of the voting stock held by non-affiliates of the issuer is $100 million or more and the issuer has had an annual trading volume of such stock of three million shares or more.

We note that this proposed definition has no direct counterpart to any existing SEC rule and serves to combine several concepts into one rule -- old Form S-3 eligibility requirements and a Regulation M actively-traded concept. We perceive no reason for FINRA to create its own definition to identify seasoned issuers and would recommend as discussed above that, at a minimum, FINRA define "experienced issuer" by reference to existing SEC rules.

well-established. Rule 5110 impedes the access to the capital markets that we believe the SEC anticipated in adopting the reforms and there simply is no justification for creating a "speed bump" to Form S-3/F-3 eligible issuers' accessing the capital markets.

In light of the now well-established market practices with Form S-3/F-3 eligible issuers, we believe that these issuers do not need FINRA's protection in the negotiation of underwriting terms and arrangements. These issuers have been subject to the reporting requirements of Sections 12 and 15(d) of the Securities Exchange Act of 1934 for at least 12 months and are generally closely followed by the investing public and by market professionals. We believe that market forces are sufficient to ensure fair and reasonable underwriting terms and arrangements for this category of issuers and that FINRA's oversight in this regard creates an unnecessary speed bump to these issuers' accessing the capital markets. Nor do we see how requiring an additional 24 months of reporting history enhances the ability of these issuers to fend for themselves, particularly in the case of WKSIs; in our view, this aspect of the "experienced issuer" definition has no rational basis.

In addition, the continued application of Rule 5110's filing requirements to offerings of securities registered on Forms S-3 and F-3 is no longer serving any useful purpose. The Form S-3/F-3 shelf base prospectus is often submitted to FINRA by the issuer at a time when FINRA member firms have not been identified to participate in an offering from the shelf, underwriting terms and arrangements have not been agreed upon, and, indeed, a specific offering may not even have been contemplated. At that time, FINRA issues a no-objections letter immediately upon payment of the filing fee (which, for a WKSI shelf, is $225,500). In respect of shelf take down offerings, FINRA likewise issues immediate clearance and, in the case of takedowns from a WKSI shelf, does not require that any filing at all be made under Rule 5110. Since at the time the shelf base prospectus is submitted there are no underwriting terms or arrangements for FINRA to review, FINRA is simply in no position to ensure that participating member firms are

complying with Rule 5110's substantive requirements. And when underwriting terms and arrangements have been agreed upon with respect to a takedown from the shelf, FINRA is not reviewing the information submitted relating to those terms and arrangements (and not requiring submission of such information for WKSIs). For these reasons, we recommend that offerings of securities registered on Forms S-3 and F-3 be exempt from all of the Rule's requirements. At a minimum, we believe WKSIs should be exempt entirely from the Rule.

We also believe that all offerings of investment grade debt, preferred stock and other fixed-income securities should likewise be exempt from Rule 5110 altogether. In our experience, these offerings involve the tightest underwriting spreads and are intensely negotiated by issuers. There is, again, simply no need in this market for Rule 5110 to act as a speed bump to an offering.

FINRA Should Exempt from all Conduct Rules Offerings by S-3 and F-3 Eligible Issuers and Investment-Grade Debt, Preferred Stock and Other Fixed-Income Securities

We would also ask FINRA to exempt offerings by S-3/F-3 eligible issuers and offerings of investment-grade debt, preferred stock and other fixed-income securities from all "Conduct Rules" and to treat these offerings in the same manner as offerings conducted pursuant to Rule 144A. In our view, application of the FINRA Conduct Rules to these offerings creates incentives to utilize Rule 144A and other exemptions from SEC registration. We do not believe that this is preferable from a capital markets or regulatory perspective. Once again, market practices with these types of issuers/offerings are well-developed and application of the FINRA Conduct Rules, in our view, creates unnecessary speed bumps. This is especially true under FINRA Rule 5121 where a "conflict of interest" often arises just from a debt repayment to an affiliate of a member firm.

In any event, we believe that, at a minimum, the requirement for a qualified independent underwriter in Rule 5121 should not apply to any offerings by Form S-3/F-3 eligible issuers.

Rule 5130 – Restrictions on the Purchase and Sale of Initial Equity Public Offerings ("New Issue Rule")

FINRA implemented the New Issue Rule to protect the integrity of the public offering process. The Rule is designed to ensure that member firms participating in the offering make bona fide public offerings of securities at the offering price, and do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to a member, and to ensure that industry insiders (that is, members and their associated persons), do not take advantage of their "insider" status to gain access to new issues for their own benefit at the expense of the public customer. We believe that the Rule, as a general matter, has been effective in this regard, but believe that the reach of "restricted person" status is too broad and the de minimis exemption has not been effective in permitting non-restricted persons to participate in public offerings, particularly when such participation is via a collective investment account. We believe that FINRA could address this unintended consequence in either of two ways: raise the threshold within the de minimis exemption to 25 percent, which is the current threshold in the de minimis exemption in Rule 5131, or revise the definition of "restricted person" to exclude administrative personnel and non-investment banking personnel and to exclude entirely member firms not participating in the offering.

The De Minimis Exemption is Not Operating to Allow Non-Restricted Persons in Collective Investment Vehicles to Participate in Public Offerings

When FINRA adopted the New Issue Rule, it included an exemption from the Rule's prohibition that permits a FINRA member firm to sell new issue to an account if the interests of restricted persons do not exceed 10 percent in the aggregate. In creating

the de minimis exemption, FINRA noted that allocations to accounts that are owned 90 percent or more by non-restricted persons generally do not present concerns underlying the Rule, and while it is true that restricted persons may receive some benefit from new issue, nearly all of the benefit flows to non-restricted persons. FINRA expressly permits the "carving out" of the interests of restricted persons in a collective investment vehicle so that the non-restricted co-investors can participate in the new issue even when the account may be beneficially owned in excess of 10 percent by restricted persons. Our experience, however, is that collective investment vehicles are unwilling to engage in the administrative burden of carving out the interests of restricted persons and are, as a result, denying participation in new issue offerings altogether to collective investment vehicles in which restricted persons own more than 10 percent.

We believe that FINRA could increase the de minimis threshold to 25 percent, as is currently the case in Rule 5131, without jeopardizing the concerns the Rule is attempting to address. Such an increase would permit more public investors to participate in initial public offerings, which participation is largely through collective investment vehicles as a practical matter. Aligning the de minimis threshold in Rule 5130 to that in Rule 5131 would also ease the burden of compliance in the situation where a collective investment vehicle has investors that are Rule 5130 restricted persons and investors that are Rule 5131 covered persons, which we have observed is not uncommon. Under the current construct, a collective investment vehicle that has investors that are associated persons of a FINRA member firm, and also has investors who are executive officers or directors of a covered non-public company, would need to take the lower threshold. There does not seem to be any practical reason to impose different thresholds in the two rules.

The Definition of Restricted Person Should be Narrowed

We also believe that the definition of "restricted person" should be amended to exclude individuals who are associated with, or employed by, broker-dealers but who are administrative personnel or non-investment banking personnel. Currently, the definition includes "persons associated with a member firm", which includes many individuals who have no decision-making authority, and also includes all employees of a broker-dealer, including those in purely administrative roles, as well as their immediate family members who receive material support from, or provide material support to, the employee. Including administrative personnel and members of their immediate family is simply unnecessary, in our view. We suggest that the Rule be limited to the situations where its concern is the greatest – investment banking personnel. Investment banking personnel are those who may have a decision-making role in allocating securities in an offering. Administrative personnel and personnel not involved in the investment banking business (and their immediate family members) are, in fact, very similar to members of the "public" the Rule is designed to protect.

At the very least, we would ask FINRA to consider limiting "restricted person" status in respect of broker-dealer personnel to personnel of those broker-dealers that are participating in the subject public offering. Personnel of member firms not participating in the offering are more fairly viewed as part of the "public", in respect of that offering. Encompassing employees of these firms (and their immediate family members) within the Rule is clearly overbroad.

FINRA Should Clarify that Offerings Conducted under Regulation S are not "New Issues" under the Rule

We would also ask FINRA to clarify that public offerings conducted under Regulation S, which occur outside the United States, fall outside the definition of "New Issue" in Rule 5130. It may well be that, as a practical matter, FINRA member firms do

not participate in offerings conducted under Regulation S. We believe, though, that the Rule would benefit from clarity on this point and would be most helpful to FINRA member firms that have associated persons dual-hatted with a non-US affiliated broker-dealer.

* * *

Once again, we appreciate the opportunity to submit these comments. If you have any questions, please contact Robert Buckholz at 212-558-3876, Robert Reeder at 212-558-3755, or David Harms at 212-558-3882.

Sincerely,

Sullivan & Cromwell LLP

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